

Before the Commissioner of Securities State of Missouri

Case No. AP-05-13

IN THE MATTER OF:

Waddell & Reed, Inc. CRD# 866
Keith A. Tucker, Chairman of the Board, CRD# 1326245
Robert J. Williams, EVP, CRD# 468213
Robert L. Hechler, Retired, CRD# 800216
Mark P. Buyle, Chief Compliance Officer, CRD# 2656200
Michael J. Blomberg, Registered Representative, CRD# 1484632
Bobby H. Bloesch, Registered Representative, CRD# 1228097
Glenda R. Bond, Registered Representative, CRD# 1959038
Bryan K. Bowles, Registered Representative, CRD# 2238313
Dean K. Buford, Registered Representative, CRD# 1221185
Robert J. Drury, Registered Representative, CRD# 3017581
Phillip K. Fine, Registered Representative, CRD# 2227284
Donald J. Gravlin, Registered Representative, CRD# 1910055
Robert L. Nutt, Jr., Registered Representative, CRD# 1327172
Mary F. Sharek, Registered Representative, CRD# 1069533
John A. Stewart, Registered Representative, CRD# 4299802
Richard A. Surber, Registered Representative, CRD# 2170368
George D. Sutton, Registered Representative, CRD# 1983478
Charles H. Trotter, Registered Representative, CRD# 3009155
Christopher R. Wade, Registered Representative, CRD# 2049695
Carroll W. Wilkerson, Registered Representative, CRD# 1395035

Respondents,

Serve all at:

6300 Lamar Ave
Overland Park, KS 66202-4200

**SUMMARY ORDER OF SUSPENSION OF WADDELL &
REED'S BROKER-DEALER REGISTRATION, SUMMARY
ORDER TO SUSPEND THE ABOVE LISTED
REPRESENTATIVES AND ORDER TO SHOW CAUSE WHY
WADDELL & REED, INC., TUCKER, WILLIAMS, HECHLER,
BUYLE AND THE ABOVE LISTED REGISTERED**

REPRESENTATIVES SHOULD NOT BE BARRED AND/OR CENSURED

On the 25 th of March 2005, Mary S. Hosmer, Assistant Commissioner of Securities for the Securities Division, submitted a petition for summary suspension of Waddell and Reed's registration in Missouri , a summary suspension of the registration of the above listed Registered Representatives of Waddell and for an Order to Bar and/or Censure all of the above listed Respondents.

FINDINGS OF FACT

1. Waddell & Reed, Inc., ("Waddell") is a Missouri registered broker-dealer based in Overland Park, Kansas.
2. Waddell is owned by Waddell & Reed Financial, Inc. a Delaware Corporation and has an address of 6300 Lamar Ave, Overland Park, KS 66202.
3. Keith A. Tucker ("Tucker") is Chairman and CEO of Waddell & Reed Financial, Inc.
4. Robert Williams ("Williams") is Waddell's Executive VP and National Sales Director.
5. Robert Hechler ("Hechler") was the President, CEO and CFO of Waddell in 2001, and was the Executive Vice President and Chief Operating Officer of Waddell & Reed Financial Inc. He is now retired but is still a securities principal with Waddell.
6. Mark P. Buyle ("Buyle") is currently the Chief Compliance Officer and the Vice President, Assistant Secretary, Chief Legal Officer and Associate General Counsel of Waddell.
7. The following were Missouri-registered securities agents and or investment advisers (in this document these will be collectively referred to as "registered representatives") with Waddell who solicited one or more Missouri investors to switch their variable annuity policies: Michael J. Blomberg, Bobby H. Bloch, Glenda R. Bond, Bryan K. Bowles, Dean K. Buford, Robert J. Drury, Phillip K. Fine, Donald J. Gravlin, Robert L. Nutt, Mary F. Sharek, John A. Stewart, Richard A. Surber, George D. Sutton, Charles H. Trotter, Christopher R. Wade, and Carroll W. Wilkerson.
8. Until 2001, Waddell and its Missouri-registered representatives sold, among other things, United Investors Life Insurance Company ("UILIC") variable annuities to Waddell's Missouri customers.
9. In 2001, Waddell and UILIC had a dispute regarding their business relationship that resulted in litigation in Alabama.
10. In early 2001, Hechler, Williams and others at Waddell encouraged Waddell registered representatives in Missouri and in other states to replace UILIC variable annuities with Nationwide Insurance Co. ("Nationwide") variable annuities.

11. From January 2001 to March 2001, Hechler issued a series of memoranda to the Waddell registered sales force encouraging the Waddell sales force to replace UILIC variable annuities with Nationwide variable annuities. Hechler stated, among other things, that:
 - a. UILIC had the right to reassign variable annuity policies to non-Waddell representatives; and
 - b. UILIC could replace Waddell's underlying mutual funds with other mutual funds, in which case Waddell's registered representatives' trailing commissions would cease.
12. On April 6, 2001, Williams sent a memo to Waddell's regional managers that included a list of all UILIC policies for each registered representative in their district and a Question & Answer ("Q&A") sheet regarding the proposed exchange of Variable Annuities.
13. The Q&A sheet gave no guidance to assist the registered representatives in determining the suitability in exchanging Missouri investors' variable annuities.

SWITCHES IN MISSOURI

14. In 2001 to 2002, Waddell's Missouri-registered representatives contacted Missouri investors who owned UILIC policies and solicited these investors to switch their policies to Nationwide policies.
15. In March 2005 representatives from the Missouri Securities Division contacted Missouri investors who stated that the Waddell registered representatives told them, among other things, that:
 - a. the switch to the new annuity was in the investors' best interest;
 - b. the Nationwide policy provided more flexibility for the investor than the UILIC policy;
 - c. the Nationwide policy was an overall better product; and
 - d. if the investor did not switch to the Nationwide policy their registered representative would no longer be able to service the investors' account.
16. The Division's investigation revealed the following information:
 - a. Many Missouri investors stated, among other things, that they agreed to the switch because the registered representative recommended it;
 - b. From 2001 to 2002, Waddell and its registered representatives switched over 350 Missouri investors from UILIC variable annuities to Nationwide annuities; and

- c. Waddell management including Williams, Hechler and the senior management in the marketing, sales management, and compliance departments were kept informed of the large numbers of switches that occurred.
17. From January 2001 to August of 2002, Waddell and its registered representatives earned an estimated \$1.6 million in commissions from the 350 Missouri investor's annuity switches. In addition, these switches cost these Missouri investors approximately \$400,000 in surrender fees. Of the Missouri investors who switched from the UILIC policy to a Nationwide policy:
- a. All investors incurred a new surrender charge period of 7 or 8 years;
 - b. Approximately 88% incurred a lower guaranteed death benefit;
 - c. Approximately 83% of the investors chose the 3% credit rider which was sold as a 3% bonus but actually increased the expenses per year for 7 years, essentially making the customers pay back the 3% plus interest; and
 - d. Ten switches were under the minimum initial investment (\$15,000) of the new annuity which caused the customers to pay an extra 0.25% annual fee on the balance. This minimum initial investment was not present in the old annuity.
18. On January 14, 2004, The National Association of Securities Dealers ("NASD") filed an action alleging, among other things, that:
- a. Waddell violated NASD Conduct Rules 2310 and 2110 by failing to provide its advisors with adequate guidance, analytical tools, or criteria for making the critical suitability analysis required for recommending variable annuity exchanges;
 - b. Waddell did not have adequate mechanisms for measuring or determining the cost and the potential long-term benefit or detriment of an exchange for each customer, taking into account relevant objective factors, including age, sex, surrender charges, M&E expenses, policy features (including annuitization rates), and the costs and benefits of the particular optional policy features chosen by the customers.
 - c. Waddell had no specific guidelines or objective criteria by which registered representatives could determine whether a potential exchange would be suitable for individual clients or classes of clients.
 - d. Waddell agents recommended variable annuity exchanges without having reasonable grounds for believing that the recommendations were suitable for the customers based on their security holdings and their financial situations and needs.
 - e. Waddell failed to establish and maintain a supervisory system

reasonably designed to achieve compliance with NASD Conduct Rule 2310, in violation of NASD Conduct Rules 3010(a) and 2110. The supervisory system did not include specific, objective criteria or guidelines which advisors and division managers could apply to determine which categories of proposed exchanges were suitable or unsuitable, or required further review. Without this information, managers were not able to determine whether there was a reasonable basis for a recommended switch between the UILIC and Nationwide variable annuities.

f. Division managers and/or registered representatives raised concerns with members of Waddell senior management, including Williams and Hechler about their inability to conduct an adequate review of the proposed switches from UILIC to Nationwide.

COUNT 1

Grounds to Summarily Suspend, Bar or Censure Pursuant to Section 409.204 (a)(1)(2)(G) Dishonest or Unethical Practices in the Securities Business - Violation of NASD Conduct Rules

19. The facts contained in paragraphs 1 through 18 are incorporated by reference as though fully set forth here.
20. Respondent Waddell and its officers and directors violated the NASD Conduct Rules 2310 and 2110 by failing to provide its advisors with adequate guidance, analytical tools, or criteria for making the critical suitability analysis required for recommending variable annuity exchanges;
21. By violating NASD Conduct Rules 2310 and 2110, Respondent Waddell and its officers and directors engaged in a dishonest or unethical practice in the securities business and the commissioner may by order suspend, revoke Waddell, or bar or censure any officer, director, partner or person occupying a similar status or performing similar functions for a registrant pursuant to Section 409.204(a)(1)(2)(G) RSMo, 2000 and pursuant to Section 409.204(c)

COUNT 2

Grounds to Summarily Suspend, Bar or Censure Pursuant to Section 409.204 (a)(1)(2)(G) Dishonest or Unethical Practices in the Securities Business - Violation of NASD Conduct Rules

22. The facts contained in paragraphs 1 through 21 are incorporated by reference as though fully set forth here.
23. Waddell and its officers and directors failed to establish and maintain a supervisory system reasonably designed to achieve compliance with NASD Conduct Rule 2310,

in violation of NASD Conduct Rules 3010(a) and 2110.

24. By violating NASD Conduct Rules 2310, 3010 (a) and 2110 Respondent Waddell and its officers and directors engaged in dishonest or unethical practices in the securities business in violation of Section 409.204(a)(1)(2)(G), RSMo 2000.

COUNT 3

Grounds to Summarily Suspend, Bar or Censure Pursuant to Section 409.204 (a)(1)(2)(G) Dishonest or Unethical Practices in the Securities Business - Violation of NASD Conduct Rules

25. The facts contained in paragraphs 1 through 24 are incorporated by reference as though fully set forth here.
26. Respondents Michael J. Blomberg, Bobby H. Bloch, Glenda R. Bond, Bryan K. Bowles, Dean K. Buford, Robert J. Drury, Phillip K. Fine, Donald J. Gravlin, Robert L. Nutt, Mary F. Sharek, John A. Stewart, Richard A. Surber, George D. Sutton, Charles H. Trotter, Christopher R. Wade, and Carroll W. Wilkerson recommended variable annuity exchanges without having reasonable grounds for believing that the recommendations were suitable for the customers based on their security holdings and their financial situations and needs in violation of NASD Conduct Rules 2310 and 2110.
27. By violating NASD Conduct Rules 2310 and 2110, these above listed Respondents engaged in dishonest or unethical practices in the securities business in violation of Section 409.204(a)(1)(2)(G), RSMo 2000.
28. This order is in the public interest.

CONCLUSIONS OF LAW

1. §409.204(a)(1)(2)(G), RSMo Cumulative Supp. 2000 provided:

The commissioner may by order . . . suspend or revoke any registration or bar or censure any registrant or any officer, director, partner or person occupying a similar status or performing similar functions for a registrant, from employment with a registered broker-dealer or investment adviser, or restrict or limit a registrant as to any function or activity of the business for which registration is required in this state, if he finds (1) that the order is in the public interest and (2) that the applicant or registrant . . . :

(G) Has engaged in dishonest or unethical practices in the securities business.

2. Pursuant to 15 CRS 30-51.170 grounds for the denial, revocation and suspension of

registration shall include, in addition to other grounds specified in section 409.204(a) of the Act, the following "dishonest or unethical practices in the securities business"

(DD) Failing to comply with any applicable provision of the Rules of Fair Practice of the National Association of Securities Dealers, any applicable fair practice or ethical standard promulgated by the Securities and Exchange Commission or by a self-regulatory organization approved by the Securities and Exchange Commission.

3. Variable annuities are securities under federal law. SEC v. Variable Annuity Life Insurance Company of America, 359 U.S. 65 (1959).
4. The phrase "in the securities business" contained in §409.204(a)(2)(G), RSMo 2000, includes selling products that are securities under federal law.
5. §2110 of the NASD Conduct Rules (formerly Article III, Section 1 of the NASD Rules of Fair Practice) states, "A member in the conduct of his business, shall observe high standards of commercial honor and just and equitable principles of trade."
6. §2310 of the NASD Conduct Rules (formerly Article III, Section 2 of the NASD Rules of Fair Practice) states:

(a) In recommending to a customer the purchase, sale or exchange of any security, a member shall have reasonable grounds for believing that the recommendation is suitable for such customer upon the basis of the facts, if any, disclosed by such customer as to his other security holdings and as to his financial situation and needs.

(b) Prior to the execution of a transaction recommended to a non-institutional customer, other than transactions with customers where investments are limited to money market mutual funds, a member shall make reasonable efforts to obtain information concerning:

- (1) the customer's financial status;
- (2) the customer's tax status;
- (3) the customer's investment objectives; and
- (4) such other information used or considered to be reasonable by such member or registered representative in making recommendations to the customer.

7. §3010 of the NASD Conduct Rules states:

(a) Supervisory System

Each member shall establish and maintain a system to supervise the activities of each registered representative and associated person that is reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable NASD Rules. Final responsibility for proper supervision shall rest with the member. .

(b) Written Procedures

- (1) Each member shall establish, maintain, and enforce written procedures to

supervise the types of business in which it engages and to supervise the activities of registered representatives and associated persons that are reasonably designed to achieve compliance with applicable securities laws and regulations, and with the applicable Rules of this Association. .

(d) Review of Transactions and Correspondence

(1) Supervision of Registered Representatives

Each member shall establish procedures for the review and endorsement by a registered principal in writing, on an internal record, of all transactions and for the review by a registered principal of incoming and outgoing written and electronic correspondence of its registered representatives with the public relating to the investment banking or securities business of such member. Such procedures should be in writing and be designed to reasonably supervise each registered representative. Evidence that these supervisory procedures have been implemented and carried out must be maintained and made available to the Association upon request.

(2) Review of Correspondence

Each member shall develop written procedures that are appropriate to its business, size, structure, and customers for the review of incoming and outgoing written (i.e., non-electronic) and electronic correspondence with the public relating to its investment banking or securities business, including procedures to review incoming, written correspondence directed to registered representatives and related to the member's investment banking or securities business to properly identify and handle customer complaints and to ensure that customer funds and securities are handled in accordance with firm procedures. Where such procedures for the review of correspondence do not require review of all correspondence prior to use or distribution, they must include provision for the education and training of associated persons as to the firm's procedures governing correspondence; documentation of such education and training; and surveillance and follow-up to ensure that such procedures are implemented and adhered to.

8. §409.204(c), RSMo 2000 provided: The commissioner may by order summarily . . . suspend registration pending final determination of any proceeding under this section . . . Upon the entry of the order, the commissioner shall promptly notify the . . . registrant, as well as the employer . . . that it has been entered and of the reasons therefore and that within fifteen days after the receipt of a written request the matter will be set down for hearing. If no hearing is requested and none is ordered by the commissioner, the order will remain in effect until it is modified or vacated by the commissioner. If hearing is requested or ordered, the commissioner, after notice of and opportunity for hearing, may modify or vacate the order or extend it until final determination.

ORDER

NOW, THEREFORE, it is hereby ordered that:

1. Respondent Waddell's broker-dealer registration in the State of Missouri is SUMMARILY SUSPENDED.
2. Respondents Michael J. Blomberg, Bobby H. Blossch, Glenda R. Bond, Bryan K. Bowles, Dean K. Buford, Robert J. Drury, Phillip K. Fine, Donald J. Gravlin, Robert L. Nutt, Mary F. Sharek, John A. Stewart, Richard A. Surber, George D. Sutton, Charles H. Trotter, Christopher R. Wade, and Carroll W. Wilkerson agent registrations in the State of Missouri are SUMMARILY SUSPENDED.

IT IS FURTHER ORDERED that the Enforcement Section's petition to BAR or CENSURE Respondents Waddell, Keith A. Tucker, Robert Williams, Robert Hechler, Mark P. Buyle, Michael J. Blomberg, Bobby H. Blossch, Glenda R. Bond, Bryan K. Bowles, Dean K. Buford, Robert J. Drury, Phillip K. Fine, Donald J. Gravlin, Robert L. Nutt, Mary F. Sharek, John A. Stewart, Richard A. Surber, George D. Sutton, Charles H. Trotter, Christopher R. Wade, and Carroll W. Wilkerson has been set for hearing on April 7, 2005 at 10:00 a.m.

SO ORDERED:

WITNESS MY HAND AND OFFICIAL SEAL OF MY OFFICE AT JEFFERSON CITY,
MISSOURI THIS 25TH DAY OF MARCH, 2005.

ROBIN CARNAHAN
SECRETARY OF STATE

(Signed/Sealed)
DAVID B. COSGROVE
COMMISSIONER OF SECURITIES